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No. 86-1857

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1986

CONTINENTAL BANK INTERNATIONAL,

Appellant,

-against-

CITY OF NEW YORK, DEPARTMENT OF FINANCE,

Appellee.

On Appeal from the Court of Appeals
for the State of New York

MOTION TO DISMISS OR AFFIRM

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TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	2
PRELIMINARY STATEMENT	3
NEW YORK CITY LOCAL TAX LAW AND ENABLING ACT	4
STATEMENT OF THE CASE	7
ARGUMENT:	
AS AN EDGE CORPORATION IS NOT A FEDERAL INSTRUMENTALITY AND AS CONGRESS HAS NOT PROHIBITED THE TAX, THE APPEAL DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION	13
I. Congress has not prohibited the tax	14
II. An Edge corporation is not a federal instrumentality	23
CONCLUSION	34

TABLE OF AUTHORITIES

Cases

	Page
Apfel v. Mellon, 33 F.2d 805 (D.C. Cir.), cert. denied 280 U.S. 585 (1929)	33
Broad River Power Co. v. Query, 288 U.S. 178 (1933)	13
City of Houston v. Morgan Guaranty International Bank, 666 S.W.2d 524 (Tex. Ct. App. 1983), cert. denied 469 U.S. 1213 (1985)	15
Continental Bank International v. City of New York, Department of Finance, 69 NY2d 281, 506 N.E.2d 525 (1987)	4, 15
Federal Land Bank v. Bismarck Lumber Co., 314 U.S. 95 (1941)	24
First Agricultural Nat'l Bank v. State Tax Commission, 392 U.S. 339 (1968)	28, 29, 30
First Federal S. & L. v. Massachusetts Tax Commission, 437 U.S. 255 (1978)	14-15
Graves v. New York ex rel. O'Keefe, 306 U.S. 466 (1939)	23, 24

Page

M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) 27, 28, 29

Mercantile Bank v. New York, 121 U.S. 138 (1887) 15

Oklahoma Tax Comm'n v. United States, 319 U.S. 598 (1943) 21

Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342 (1949) 21

Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664 (1899) 27-28, 29, 30

Rockford Life Ins. Co. v. Ill. Dept. of Rev., ___ U.S. ____, Slip Op. (1987) 21

United States v. Boyd, 378 U.S. 39 (1964) 26

United States v. Mason, 412 U.S. 391 (1973) 21

United States v. New Mexico, 455 U.S. 720 (1982) 25, 27

Washington v. United States, 460 U.S. 536 (1983) 29

Western Union Telegraph Co. v. Massachusetts, 125 U.S. 530 (1888) 13

Page

Statutes

United States

Edge Act, 41 Stat. 378, 12 U.S.C. §§611-631 ..... 2, 4, 7, 17

12 U.S.C. §611 8

12 U.S.C. §614 33

12 U.S.C. §615 ..... 8, 9, 16

12 U.S.C. §620 25

12 U.S.C. §621 31

12 U.S.C. §625 25

12 U.S.C. §627 ..... 2, 12, 14, 21

12 U.S.C. §631 26

International Banking Act of 1978, §3, Pub. L. 95-369, 92 Stat. 607, as amended by 92 Stat. 608 10

National Bank Act of 1864, 13 Stat. 111, R.S. §5219 31

12 U.S.C. §222 (1982) 31

12 U.S.C. §548 (1982) ... 19

12 U.S.C. §1841(c)(1982) 31

P.L. 91-156, 83 Stat. 434 (1969) 19

Page

Administrative Regulation

12 C.F.R 211 ..... 8, 9, 11, 16-17, 29, 31

Legislative Materials

58 Cong. Rec. 4953..... 16

58 Cong. Rec. 4954 16

58 Cong. Rec. 4955 ..... 16, 17

58 Cong. Rec. 4956 16

58 Cong. Rec. 4957 16

58 Cong. Rec. 4958 16

58 Cong. Rec. 4959 16

58 Cong. Rec. 4960 16

58 Cong. Rec. 4969 18

58 Cong. Rec. 5073 16

58 Cong. Rec. 5074 16

58 Cong. Rec. 7853 20

58 Cong. Rec. 7854 ..... 16, 20

58 Cong. Rec. 7856 16

58 Cong. Rec. 7857 16

58 Cong. Rec. 7859 16

	Page
58 Cong. Rec. 7894	16
58 Cong. Rec. 7898	16
58 Cong. Rec. 7959	16
58 Cong. Rec. 8082	8, 26
58 Cong. Rec. 8083	8, 15, 16, 21, 26
58 Cong. Rec. 8100	16, 31
58 Cong. Rec. 8101	31
58 Cong. Rec. 8102	16, 31
59 Cong. Rec. 49	16
59 Cong. Rec. 624	16
59 Cong. Rec. 625	16
59 Cong. Rec. 626	16
Hearings on S.2427 Before Committee on Banking and Currency, 66th Cong., 1st Sess. (July 23, 1919), pp. 3-4	17
Hearings on S.2427 Before Committee on Banking and Currency, 66th Cong., 3rd Sess. (Sept. 25, 1919), pp. 102-105	19

Page

H.R. Rep. No. 473, Conference Rep. on S.2472, Nov. 17, 1919, at Amendment No. 36 20

S. Rep. No. 95-1073, 95th Cong., 2d Sess., reprinted in 3 U.S. Code Cong. & Ad. News 1421-1426 1440-1441 (1978) 12

Other Authority

Note, A Constitutional and Statutory Analysis of State Taxation of Edge Act Corporate Branches, 51 Fordham L. Rev. 994-995 (1983) 8

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CITY OF NEW YORK, DEPARTMENT OF FINANCE,

Appellee.

On Appeal from the Court of Appeals
for the State of New York

MOTION TO DISMISS OR AFFIRM

Appellee moves to dismiss the appeal or, alternatively, to affirm the judgment appealed from on the grounds that none of the questions stated in the Jurisdictional Statement presents a substantial federal question and that the questions on which the decision of the cause

depends are manifestly so unsubstantial as to require no further argument.

QUESTIONS PRESENTED

Is a corporation organized under the Edge Act (12 U.S.C. §§611-631), which has a home office in another state and a branch office in New York City, immune from taxation of the business done by the New York branch office?

Subsidiary questions are:

1. Is such an Edge corporation a federal instrumentality?

2. Has Congress prohibited, in 12 U.S.C. §627 or elsewhere, taxation of such an Edge corporation by the state in which the branch office is located?

Although appellant seeks to inject a question of the right of Edge corporations to establish domestic branches, the Court below did not hold that branch offices were unlawful, and the City's right to tax Edge corporations on their branch operations in the City does not depend on

whether or not the Federal Reserve Board was given the power to authorize domestic branches.

PRELIMINARY STATEMENT

The appeal is from a judgment of the Court of Appeals of the State of New York, entered February 19, 1987, which unanimously affirmed a judgment of the Appellate Division of the Supreme Court of that State. J.S. Appendix D1*. The Appellate Division had reviewed and unanimously confirmed, without opinion, a determination of appellee's Commissioner of Finance that appellant owed New York City financial corporation tax. J.S. Appendix B1-B2. The determination was issued after a hearing at which evidence was taken and findings made. See Findings at J.S. Appendix C1-C17.

The opinion of the Court of Appeals is

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*References preceded by "J.S." refer to pages in Appellant's Jurisdictional Statement or appendix thereto.

business in the City, in a corporate or organized capacity, upon banking corporations whether organized under the laws of New York, the laws of any other state or country, or the laws of the United States. N.Y.C. Admin. Code §§R46-37.1(a), -37.2(a). The basic tax was a percentage of "entire net income," as defined in the law, except that where such income was derived from business carried on both within and without the City, only the portion of such income derived from business carried on within the City was taxable*. N.Y.C. Admin. Code §§R46-37.4, -37.53(a).

Some pertinent portions of the City law are set forth at pages F8 to F9 of appellant's Jurisdictional Statement. In addition to the paragraphs relating to corporations organized

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*Although some of the provisions have been amended, the above description of the tax is still accurate.

under federal law which come within the definition of a taxable "banking corporation" quoted at page F9, the definition contains the following pertinent paragraphs (N.Y.C. Admin. Code §R46-37.2):

> "(a) For the purpose of this subpart a banking corporation means:
>
> (1) Every corporation or association organized under the laws of this state which is authorized to do a banking business or which is doing a banking business in the city;
>
> (2) every corporation or association organized under the laws of any other state or country which is doing a banking business in the city;
>
> * * * "

(2)

The City tax is imposed pursuant to a New York State enabling act. The enabling act (L. 1966, c. 772, §1, as amended by L. 1981, c.

1015, §8)* authorizes any city having a population of one million or more to impose specified taxes on general, financial, insurance and transportation corporations. Included is authorization for a tax such as is imposed by Article 32 of the State's Tax Law (§§1450-1468 (McKinney 1975)), with certain exceptions not here relevant. Article 32 imposes the State franchise tax on banking corporations. The City tax in question is a tax such as is imposed by this Article, but it is limited to business in the City. The State tax is applicable State-wide.

STATEMENT OF THE CASE

Appellant is a corporation organized under the Edge Act. 12 U.S.C. §§611-631. The Edge Act was enacted in 1919, shortly after World War I, (41 Stat. 378) to provide Europe with

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*The enabling act with all amendments is in the appendix to N.Y. General City Law (McKinney 1968, 1987 pocket part, pp. 131-132).

international credit and to secure foreign markets for domestic exports. See 58 Cong. Rec. 8082-8083 (statement of Rep. Phelan); Note, A Constitutional and Statutory Analysis of State Taxation of Edge Act Corporate Branches, 51 Fordam L. Rev. 994-995 (1983). Edge corporations* were permitted to provide financing for international transactions, establish overseas branches, receive deposits in the United States only when incidental to international business transactions, and invest in the stock of certain other corporations engaged in business abroad. 12 U.S.C. §615.

The Federal Reserve Board interpreted the authorization for Edge corporations to have

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*Although appellant refers to Edge corporations as banks, the Edge Act and the Federal Reserve Board regulations refer to these entities as "corporations," rather than "banks" (See, e.g., 12 U.S.C. §611; Reg K, 12 C.F.R. §211.4).

"branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States" (12 U.S.C. §615(b)) as prohibiting domestic branches. Reg. K at 12 C.F.R. §211.6 (1978). Accordingly, separate Edge corporations were formed for each state in which the incorporators wished to have an office for doing business as an Edge corporation.

Thus, prior to 1980, appellant's parent, Continental Illinois National Bank and Trust Company of Chicago ("Continental Illinois") had four subsidiaries organized under the Edge Act, each of which did business in a different state. One of these subsidiaries conducted the same business in New York City as appellant. Its home office was in the City, and it paid the City's financial corporation tax without dispute. The Edge Act from its inception to the present provided that an Edge corporation "shall be subject to tax by the State within which its home

office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business."

In 1978 the Edge Act was amended by the International Banking Act of 1978, §3, Pub. L. 95-369, 92 Stat. 607. This Act required the Federal Reserve Board "to review and revise its rules, regulations and interpretations", issued pursuant to the Edge Act, to eliminate or modify restrictions, conditions, or limitations not required by the Edge Act that (1) discriminate against foreign-owned banking institutions, (2) put Edge corporations at a disadvantage in competing with foreign-owned banking institutions, or (3) impede the attainment of the purposes of the Act, as amended (§3(a) at 92 Stat. 608).

Among the amendments made by the Federal Reserve Board to its Regulation K in 1979 was a provision that, with prior Board approval, an

states to tax Edge corporations previously subject to tax. See, e.g., S. Rep. No. 95-1073, 95th Cong., 2d Sess., reprinted in 3 U.S. Code Cong. & Ad. News 1421-1426, 1440-1441 (1978). Nor is there any indication that this was the purpose of the Federal Reserve Board in changing its former regulation which had prohibited domestic branches. Nevertheless, appellant claims that 12 U.S.C. §627, which was intended only to prevent discriminatory taxation, immunizes a branch office of an Edge Corporation from tax in the state where it is located and doing business, merely because of a change in Regulation K made for other purposes.

ARGUMENT

AS AN EDGE CORPORATION IS NOT A FEDERAL INSTRUMENTALITY AND AS CONGRESS HAS NOT PROHIBITED THE TAX, THE APPEAL DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION.

A state or political subdivision may tax a federally-franchised corporation unless the corporation is a federal instrumentality* or unless Congress, in the exercise of one of the powers granted by the Constitution, prohibits the tax. See, e.g., Broad River Power Co. v. Query, 288 U.S. 178, 181 (1933); Western Union Telegraph Co. v. Massachusetts, 125 U.S. 530, 548 (1888). As neither alternative exists with respect to Edge corporations, they are not immune from the tax in question.

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*Of course, even a federal instrumentality may be taxed if Congress consents.

I. Congress has not prohibited the tax.

A

Appellant's principal contention is that 12 U.S.C. §627 prohibits taxation of Edge corporations by states other than the home state. This contention is without merit, both because Section 627 contains no words of prohibition and because the legislative history shows that the section was not intended to immunize Edge corporations from state or local taxation.

The first sentence of Section 627 merely provides that an Edge corporation may be taxed in the state where its home office is located in a nondiscriminatory manner. The second sentence provides for nondiscriminatory taxation of shares of stock in an Edge corporation as the personal property of the stockholders. The statute speaks of no tax immunity or special tax exemption. It is the prohibition of discrimination which is the statute's function. See First

Federal S. & L. v. Massachusetts Tax Comm'n, 437 U.S. 255, 258 n.2 (1978), reflecting policy analysis of Mercantile Bank v. New York, 121 U.S. 138 (1887); statement of Rep. Phelan, 58 Cong. Rec. 8083 (1919). Both of the cases which have construed Section 627 since the Federal Reserve Board in 1979 permitted Edge Corporations to have domestic branches have reached the same conclusion and have upheld the tax there involved. City of Houston v. Morgan Guaranty International Bank, 666 S.W.2d 524 (Tex. Ct. App. 1983), cert. denied 469 U.S. 1213 (1985) (tax on shares of stock of an Edge corporation); opinion below, 69 NY2d 281, 286, 506 N.E.2d 525, 527 (1987).

The reference in Section 627 to the Edge corporation's home office state is merely descriptive of the place within the continental United States where an Edge corporation in 1919 could locate and, therefore, be subject to the state's taxing jurisdiction. Branches or agencies

were authorized only in foreign countries and in dependencies or insular possessions of the United States. 12 U.S.C. §615(b).* The Federal Reserve Board regulations expressly prohibited branches in the United States, as well as agencies to generally carry on the Edge corporation's business. Only agencies for "specific" (later changed to "special") purposes were permitted. Reg. K at 12 C.F.R. §211.6

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*The legislative history shows that Congress intended to prohibit domestic branches and understood the bill it enacted to do so. Moreover, a provision which would have expressly permitted "agencies in the United States" was deleted at the Senate-House Conference. See 58 Cong. Rec. 7854, 7856-7857, 8100, 8102; 59 Cong. Rec. 49.

It was of serious concern that the Edge corporations might become vehicles for capital concentration by "the patriots up in Wall Street." 59 Cong. Rec. 624-626. The intent was to avoid a money trust, monopolizing American sources of credit. 58 Cong. Rec. 4953-4960, 5073-5074, 7856, 7859, 7894, 7898, 7959, 8083, 8100.

(1978); see also, March 23, 1920 version at J.S., p. F10.

B

The legislative history of the Edge Act shows that Congress intended generally that Edge corporations pay state and local taxes. Certainly, the Congressional debates, read in context and as a whole, show no intent to immunize them.

(1)

The original bill, which was drafted by counsel for the Federal Reserve Bank, contained only the present 12 U.S.C. §§ 611-625, without Section 627. Hearings on S.2427 Before Committee on Banking and Currency, 66th Cong., 1st Sess. (July 23, 1919), pp. 3-4. When Senator Edge, who sponsored the bill, was asked whether immunity from state taxation was contemplated, he replied (58 Cong. Rec. 4955):

> "Not at all. *** there is no intention on the part of the original compiler of the bill to have it escape taxation *** his

any other corporation doing business in that State."

(2)

Amendments were made to the bill in the House of Representatives. One of the amendments considered would have made Edge corporations "subject to tax in the same manner and to the same extent as national banking associations." House Banking and Currency Committee Hearings, 66th Cong., 3rd Sess. (Sept. 25, 1919), pp. 102-105. This proposal was rejected,* and the bill submitted to the

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*Although appellant would analogize Edge corporations to national banks, Congress terminated the earlier immunity provisions for national banks in 1969. P.L. 91-156, 83 Stat. 434 (1969). Among other provisions a so-called permanent amendment was adopted which, after a moratorium which expired in 1976, ended all immunity of national banks, and permits any state to tax a national bank in the same manner as a bank organized and existing under the laws of the state where the national bank's principal office is located. Id., §2, now at 12 U.S.C. §548 (Supp. 1987); for moratorium

(Footnote Continued)

House on November 1, 1919 included the present Section 627, but with an added proviso limiting the authority to tax shareholding to "the city or town in which the corporation's home office is located and not elsewhere". (Emphasis supplied.) 58 Cong. Rec. 7853-7854. The proviso was deleted at the Senate-House Conference (H.R. Rep. No. 473, Conference Rep. on S.2472, Nov. 17, 1919, at Amendment No. 36), and Section 627 was enacted in its present form without the proviso. However, the proviso does show that, if Congress had wanted to limit state and local taxation to the state where the home office was located, it knew how to do so, i.e., by adding the words "and not elsewhere". Instead, as indicated by Representative Phelan, a bill

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(Footnote Continued)
provisions, see P.L. 92-213, 85 Stat. 775 (1971); P.L. 93-100, §7, 87 Stat. 342, 347-348 (1973); P.L. 94-222, §1, 90 Stat. 197 (1976).

manager, in referring to Section 627 as a whole (58 Cong. Rec. 8083):

> "This section was intended to prevent discrimination by the states in the taxation of a corporation organized under this law."

C

Where immunity from tax is claimed by virtue of an Act of Congress, the normal rule is against tax exemption by statutory implication. Oklahoma Tax Comm'n v. United States, 319 U.S. 598, 604 (1943); Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342, 366-367 (1949); United States v. Mason, 412 U.S. 391, 394 (1973); cf. Rockford Life Ins. Co. v. Ill. Dept of Rev., __U.S.__, ___ (1987) (slip op. 9-10). Thus, the provision in 12 U.S.C. §627 for nondiscriminatory taxation by the state where an Edge corporation's home office is located does not imply prohibition of taxation by other states. This is particularly so since the legislative history shows a contrary intent and, also, since

domestic branch offices were not authorized when Section 627 was enacted.

Here we have the extraordinary claim of tax immunity resulting merely from a change in the regulations of the Federal Reserve Board to permit domestic branches. While Congress in 1978 amended the Edge Act to authorize the FRB to revise its regulations to eliminate restrictions, not required by the Act, which discriminate against foreign-owned banking institutions and unnecessarily restrict Edge corporations in competing with them, there is nothing in the 1978 legislation or its history to suggest that Congress intended to prohibit taxation by the states where Edge corporations carried on their business and had been taxed for many years. Certainly, such an important change in policy and such a serious encroachment upon the states' power to tax would have been clearly stated in the 1978 legislation, itself.

As Justice Stone said in Graves v. New York ex rel. O'Keefe, 306 U.S. 466, 480 (1939), "[s]ilence of Congress implies immunity no more than does the silence of the Constitution."

II. An Edge corporation is not a federal instrumentality.

Appellant did not establish, nor could it do so, that it is a federal instrumentality and that, therefore, express federal permission to tax it is required. An Edge corporation is plainly lacking in those characteristics which determine that status and confer tax exemption on that ground.

Rather, appellant proposes a novel "federal banking instrumentalities" rule, derived by extending now-obsolete national bank cases to the present circumstance. However, this self-serving rule does not survive scrutiny because appellant's analogy of Edge corporations to national banks is not supported by law, legislative history or fact.

A

There is no express designation of Edge corporations as federal instrumentalities, as is the case with other institutions expressly given that status. See, e.g., Federal Land Bank v. Bismarck Lumber Co., 314 U.S. 95, 96-97 (1941) (mortgages executed to Federal land banks declared by Section 26 of Federal Farm Loan Act of 1916 to be instrumentalities of Government of United States); Graves v. New York ex rel. O'Keefe, 306 U.S. 466, 476 (1939) (Home Owners' Loan Corporation declared by Section 4(a) of Home Owners' Loan Act of 1933 to be instrumentality of United States).

Nor is there any implied designation stemming from their inna[illegible] character. Edge corporations are wholly lacking in those organizational and operational characteristics which would indicate that they have been "incorporated into the government structure" and which this Court has held to be necessary to

the United States is liable for the payment of any bond or other obligation * * * issued or incurred by any * * * [Edge corporation]." 12 U.S.C. §631.

Third, although Edge corporations perform a beneficial service, fostering international trade, performance of such service is not governmental, and does not confer tax immunity. United States v. Boyd, 378 U.S. 39, 44 (1964). There is a significant difference between an essential governmental function -- one performed by or at the behest of the government -- and a mere beneficial service -- one performed for the benefit of a narrow segment of the commercial public.

Last, any implication of federal instrumentality status based on the federal charters granted to Edge corporations is negated by the fact that federal charters were designed merely to enhance their prestige, particularly abroad. 58 Cong. Rec. 8082-8083. Hence,

federal incorporation was primarily for the benefit of the Edge corporations, not the federal government. Moreover, Edge corporations are privately owned, profit motivated institutions, a status clearly at odds with that of a federal instrumentality. See, e.g., United States v. New Mexico, 455 U.S. at 739, 740.

B

(1)

Appellant argues that there is a "long-established" and "long-standing" constitutional principle that the states are without power, unless explicitly authorized by Congress, to tax federally created banks, J.S. 10, 20, and that this principle applies to Edge corporations. Appellant states that this principle was "first announced" in M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) (J.S. 9), "antedate[s] the Edge Act," citing Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664, 668 (1899) (J.S. 10), and was "approved

by this Court" in First Agricultural Nat'l Bank v. State Tax Commission, 392 U.S. 339, 340 (1968) (J.S. 9).

(2)

There are numerous short-comings in appellant's novel "federal banking instrumentalities" rule, resulting from errors in analysis of both case law and the particular structure and operation of Edge corporations.

M'Culloch, supra, involved banking only incidentally. The functions of the second Bank of the United States were significant only to authenticate its status as an instrument employed in the substantive operations of the federal government. M'Culloch, 17 U.S at 407-09, 422-23. It was held to be impossible for the nascent federal system to survive if Maryland could, by taxation or otherwise, control a

functionary having that status. Id. at 424, 431-33.*

That this Court recognizes this holding and import of M'Culloch is shown by its statement in Washington v. United States, 460 U.S. 536, 547 (1983), that in M'Culloch "the Court laid down the principle that the property, functions, and instrumentalities of the Federal Government are immune from taxation by its constituent parts." Appellant cannot point to any specific page reference in M'Culloch, nor even suggest any reference, where its purported rule is stated.

Appellant's citations of Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664 (1899), and First Agricultural Nat'l Bank v. State Tax Commission,

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*Nevertheless, M'Culloch recognized the right of the states to tax the Bank's real estate and shareholder capital, prohibiting only those state taxes that conflicted with the Bank's federal governmental aspects. M'Culloch, 17 U.S. at 436.

392 U.S. 339 (1968), lend no additional support. The decision in Owensboro was based upon the assumption that national banks, as agencies created for carrying into effect national powers granted by the Constitution, were instrumentalities of the federal government. Owensboro, 173 U.S. at 667-68. In short, Owensboro addressed a specific problem; its rationale has not been shown to have been applied to any other federally chartered financial institutions.

Similarly, this Court's decision in First Agricultural Nat'l Bank, supra, did not confirm the principle that all federal banking institutions are tax-immune federal instrumentalities. Rather, it was a statement that the principle of tax-immune, federal instrumentality status for national banks had become settled law and could be changed only by Congress. First Agricultural Nat'l Bank, 392 U.S. at 346. Thus,

appellant cannot cite any specific case where its novel rule is enunciated or even suggested.

(3)

The differences between Edge corporations and national banks are more extensive and more significant than appellant would have this Court believe. Edge corporations are not "banks," nor does the statute or Federal Reserve Board refer to them as such.* 12 C.F.R. §211. Edge corporations were excluded from the definition of "bank" when the Bank Holding Company Act was enacted in 1956, 12 U.S.C. §1841(c) (1982); national banks were included. Edge corporations are not permitted to be members of the Federal Reserve system; national banks must be members. 12 U.S.C. §§222, 621 (1982).

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*Congress did not regard them as "banks". 58 Cong. Rec. 8100-8102.

only the second sentence of Section 627, dealing with shareholder taxation, has a comparable provision in Section 5219.

Appellant's contention that Section 627 and Section 5219 are in pari materia is also without merit. Apfel v. Mellon, 33 F.2d 805 (D.C. Cir.), cert. denied 280 U.S. 585 (1929), the only case cited by appellant to support this argument, construes a different section of the Edge Act (§614) dealing with approval of applications to establish Edge corporations. It has nothing to do with taxation or Section 627. The fact that Congress deliberately chose a different tax provision for Edge corporations than for national banks establishes that Congress intended different tax treatment.

Appellant's interpretation of Section 627 seeks for Edge corporations a greater tax exemption than national banks have ever enjoyed. Apart from the patent lack of merit in

this position, there is nothing in the legislative history to support it.

CONCLUSION

The appeal should be dismissed or the judgment of the Court below affirmed.

Dated: July 10, 1987

Respectfully submitted,

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